Entry Cohort-Effects at the Firm Level: Internal Labor Markets or Competitive Wage Differences?

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Influential studies have shown that external labor market conditions can have persistent effects on wages within firms (Baker, Gibbs, and Holmstrom 1994). Such lasting differences could signify important departures of firms' wage setting from the standard competitive framework (Beaudry and DiNardo 1991). On the other hand, they could represent cohort-specific differences in on-the-job training (Gibbons and Waldman 2004). To test whether variation in firms' wage setting is driven by internal labor markets or by differences in productivity, we analyze the persistence of firm cohort effects using evidence from job changers. Temporary rents should dissipate for involuntary job changers, while differences in human capital due to training should remain even at new employers. To do so, we have access to 25 years of longitudinal earnings and employment information for all employees that ever worked in a large sample of German establishments. Preliminary results show that workers seem to keep firm entry-cohort premiums even after leaving the firm. However, we also find that wages of high-wage cohorts grow slower within the firm and that exit rates of workers from these cohorts are higher. Thus, it appears the firm adjusts to high initial cohort wages partly by raising workers' productivity through training and partly by compressing wages and firing expensive workers.

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